UNIVERSITÀ POLITECNICA DELLE MARCHE
FACOLTÀ DI ECONOMIA “GIORGIO FUÀ”

Corso di Laurea Magistrale in International Economics and Commerce

OECD Model's experimental analysis: Source versus Residence dilemma.

The Facebook case explained through Article 4

Relatore: Chiar.mo
Prof. Samperna Simone

Tesi di Laurea di:
Giulio Pedica

Anno Accademico 2018– 2019

INDEX

INTRODUCTION 1
ABSTRACT 3
CHAPTER 1 4
1.1 PRESENTATION OF THE SUBJECT 4
1.2 HISTORICAL INSIGHTS 5
1.3 THE MEMBERS 8
1.4 THE ORGANIZATIONAL STRUCTURE 10
1.5 INTERNATIONAL OBJECTIVES 12
1.6 NATIONAL AND INTERNATIONAL LAW 13
1.7 OECD DUTIES IN MATTER OF TAXATION 16
1.8 TAX SYSTEM FROM ALL OVER THE WORLD 19
1.9 PLACE OF EFFECTIVE MANAGEMENT 22
1.10 UPDATES NEEDED 25
CHAPTER 2 29
2.1 COMPANY OVERVIEW 29
2.2 FINANCIAL INSIGHTS 31
2.3 THE CASE OF FACEBOOK INC. 33
2.4 THE SUBSIDIARY GAMES 35
2.5 THE ATTRACTIVENESS OF IRELAND 40
2.6 THE DOUBLE IRISH 45
2.7 PROSPECTS AND CONCERN ABOUT THE FUTURE 51
CHAPTER 3 56
3.1 DIGITALISATION 56
3.2 THE ACTIONS 58
3.2.1 THE INCLUSIVE FRAMEWORK 61
3.2.2 HARMFUL TAX PRACTICES 63
3.2.3 COUNTRY-BY-COUNTRY REPORTING 64
3.2.4 TREATY ABUSE 65

3.2.5 DISPUTE RESOLUTION 66
3.2.6 OTHER BEPS ACTIONS...67
3.2.7 GENERAL EVALUTATION OF BEPS 68
3.3 THE PHYSICAL PRESENCE PROBLEM 71
3.4 THE PROGRAMME OF WORK...72
3.5 A FRESH NEW START..73
3.6 THE UNIFIED APPROACH...75
3.7 COUNTRIES RESPONSES 77
3.8 ITALY’S WEB TAX 79
CONCLUSIONS 82
SITOGRAFIA..86
BIBLIOGRAFIA 89

INTRODUCTION

There is a fine line between tax avoidance and tax evasion. The objective of this thesis is to demonstrate how outdated is the international taxation in relation to the development of the digital economy through the Facebook case.

Specifically, we are going to analyse the Article 4 of the Organization for Economic Co-operation and Development (OECD) model tax convention, for which the principle through profits are taxed is based on the physical presence.

Digging in the Facebook case it is shown how the utilization of some loopholes in the global tax system, in the specific matter the “Double Irish”, allow multinationals to create tax avoidance strategies. This pattern is exploited through the utilization of Intellectual Property and Transfer Pricing technique, that enables multinational to increase their profit basically choosing where to pay the minimum amount of taxes. The game is simple: Through a wide range of subsidiaries and transfer pricing techniques multinationals absorb profits in highest tax jurisdiction showing them instead in a country with low tax jurisdiction, or a “Tax Haven”.

The principal purpose of this analysis is to enter in the OECD point of view and see how they are changing the rule of the game because clearly the taxpayers are one step ahead the tax authorities.

In the first chapter it will be recalled the history of the OECD, starting from the league of nations, and by breaking down its structure it will be discovered what are the objectives, the members and especially why it is in charge of taxation, providing

a deep explanation on the difference between national and international law. Talking about international taxation it will be understood the differences of approach between the various nations. To conclude, by introducing the OECD model tax convention, it will be discovered the relationship between source and residence described in its Article 4 and the subsequent updates that have characterized it.

In the second chapter it will be introduced more deeply the Facebook case, briefly analysing the company and its background. Then, the attention will be shifted to the reasons why they transferred the Intellectual Property to Ireland trough the utilization of two subsidiaries: "Facebook Ireland Holding Unlimited" and "Facebook Ireland Limited". Eventually, it will be analysed the Double Irish case by estimating how many tax benefits it has brought to Facebook Inc. that, once again, is resident in California.

In the third and final chapter it will be adopted the OECD's point of view by showing the problems that digitalization brings to the international taxation. It will also be evaluated the pattern of the international organization, through its moves, the BEPS action, the documents and various rulings which brings us in the situation that we are nowadays. Lastly, digging into the physical presence problem it will be introduced the "Programme of Work" timeframe proposed by the OECD and how it should put the word "end" on the era of tax avoidance.

ABSTRACT

Lo scopo di questa tesi è di dimostrare quanto la tassazione internazionale non sia capace di stare al passo dell'economia digitale. La difficoltà è relativamente tecnica in quanto l'attribuzione di un luogo, per motivi fiscali, alla vendita di un servizio non fisico non può essere affrontata con leggi finanziarie formate per un secolo che si è concluso vent'anni fa.

Nel primo capitolo, verrà analizzata l'Organizzazione internazionale per la Co-Operazione e lo Sviluppo Economico (OCSE) ed in particolare il suo modello di convenzione fiscale. Nello specifico, l'articolo 4 nel quale è spiegato che il vincolo che lega la tassazione di un ente, operante oltre i propri confini nazionali, è la mera presenza fisica. Questo vincolo verrà poi approfondito nel secondo capitolo attraverso il caso Facebook, che partendo da questo scenario ha sfruttato una scappatoia denominata "Double Irish" nel sistema fiscale irlandese, per ridurre al minimo la base imponibile delle tasse attraverso un sistema di aziende controllate e paradisi fiscali. Nel terzo capitolo infine sarà adottato il punto di vista dell'OCSE analizzando come vengono affrontati i problemi creati dalla digitalizzazione. Attraverso le mosse, le sentenze e le azioni dell'organizzazione si valuterà il suo operato nella ricerca di una tassazione equa. Concludendo con il "Programme of Work" verrà analizzato il nuovo modello internazionale, prestando particolare attenzione alla "significant digital presence" ed al nuovo approccio attraverso il quale si porrà fine all'era dell'evasione fiscale.

CHAPTER 1

1.1 PRESENTATION OF THE SUBJECT

The Organisation for Economic Co-operation and Development (OECD) is an intergovernmental organization (IGO) that was founded in 1961. It is composed by 36 countries working together to reach a common goal that is: "to shape policies that foster prosperity, equality, opportunity and well-being for all."

The organization objective is to stimulate economic progress by encouraging investments and competitiveness worldwide and, at the same time, maintain financial stability by achieving higher levels of sustainable economic growth and employment amongst the member countries.

In 2019, the OECD member countries collectively comprised 66.4% of global nominal Gross Domestic Product (€ 47,13 trillion) and 43.1% of global GDP (€ 50,07 trillion) at purchasing power parity. Those data further explain us that OECD are high-income developed countries with a relatively elevated Human Development Index (HDI).

The OECD is an official United Nations observer and is mainly financed by the Member States, whose compulsory contributions finance the main part of the budget. They are determined by a basic share, divided equally among all members, and by a main share, calculated based on the relative size of Gross National Product (GNP). In 2019, the United States, with 20.5% of compulsory contributions, turned

out to be the main contributor country, followed by Japan with 9.4% (Italy is sixth with 4%). Compulsory contributions are supplemented by voluntary contributions from both member and non-member countries.

The OECD official headquarter is in Paris and is represented abroad by four Centres located in Berlin, Mexico City, Tokyo and Washington to deal with the visibility and impact of the Organization's work. Recently have been established local Offices in Beijing, Moscow and Jakarta but only to facilitate the respective countries' collaboration with the Organization. Other centres outside Paris have been set up for more specific objectives, for example in Italy we have the Local Economic and Employment Development (LEED) OECD centre in Trento for the implementation of technical cooperation or training.

The OECD recognises the valuable contribution of civil society to public life and attaches great importance to dialogue with companies and workers. To this end, there are two consultative bodies, The Business at OECD (BIAC), which represents companies, and the Trade Union Advisory Committee (TUAC) which represents workers' interests.

1.2 HISTORICAL INSIGHTS

Digging into the formation of the International organization we have to take a step back to the beginning of the 20th century, when countries allying themselves only

to prevent from other countries who were perceived as a threat. Those alliances were usually kept secret, increasing the climate of fear and mistrust. Moreover, despite being created to avoid conflict, they ended up being a key factor in causing the First World War.

Subsequently the end of the war, in 1920, United States president Woodrow Wilson proposed a ban on secret treaties consequent at the formation of the first intergovernmental organization named "League of Nations". The organisation's primary goals, as stated in its Covenant[1], included preventing wars through collective security and settling international disputes through negotiation and arbitration. Other issues and related treaties included labour conditions, the treatment of native inhabitants, human and drug trafficking, the arms trade, global health, the treatment of prisoners of war and protection of minorities in Europe.

The League of Nations turn out to be the first historical place where nations could bring their disputes to be resolved. There was an enormous support from many countries, especially smaller states. Larger states like Britain and France were cautiously in favour. Unfortunately for the League, Wilson was unable to persuade the US Congress to join. Despite this, the League opened its doors and held the first session in 1920.

[1] Covenant of the League of Nations, 1920

The Second World War marked the failure of the League of Nations which “reborn” in 1948 in Château de la Muette, in Paris (France), under the name of Organisation for European Economic Co-operation (OEEC). The reasons are related to the administration of American and Canadian aid in the framework of the Marshall Plan for the reconstruction of Europe after the Second World War. The biggest difficulties arose with some beneficiary countries proving incapable of reaching agreement on prior harmonisation of their long-term programmes. This pattern escalated in autumn 1949 when the Americans were changing their policy regarding aid, which they considered insufficiently directed towards economic integration. Formerly, Marshall Plan credit had been used mainly to make up the European countries' dollar balance deficit.

In November 1949 the head of the European Cooperation Administration, Paul Hoffman, point out the fact that OEEC is not making enough for freeing trade. Consequently, European countries made up an agreement to free 50% of private import trade in foodstuffs, manufactured products and raw materials.

Despite this action, by the end of 1950, 60% of private intra-European trade had been released thanks to OEEC action, a percentage that rose to 84% in 1955 and 89% in 1959.

In June 1950 Dirk Stikker, Chairman of the OEEC Council, put forward an action plan for the economic integration of Europe through specialisation of activities, division of labour and the creation of a single European market. Countries with

heavy state trade were asked to issue long-term purchase contracts at reasonable prices, and a joint list of objects for freeing was proposed. A European fund was set up to mitigate the effect of increased competition for firms and other proposals were made to accelerate the freeing of trade, in order to give the OEEC power to organise the European economies or rationalise them.

The OEEC declined after 1952 due to the unexpected end of the Marshall Plan who create a subsequent shift in favour of the North Atlantic Treaty Organization (NATO). The mutual security policy that merge economic aid and military assistance almost bring the organization to its decline.

But, in September 1961, the OEEC was reformed into the Organisation for Economic Co-operation and Development (OECD) and membership was extended to non-European states. It consisted of the European founder countries of the OEEC plus the United States and Canada.

1.3 THE MEMBERS

The official founding members are Austria, Belgium, Canada, Denmark, West Germany, Luxemburg, Greece, The Netherlands, Iceland, Norway, France, Ireland, Italy, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom and United States.

During the next 12 years Japan, Finland, Australia, and New Zealand also joined the organisation. After the 1991 program in central Europe “Partners in Transitions” Poland, Hungary, Czech Republic and Slovakia joined the organization as well as Mexico and South Korea in the end of the century.

In the 1990s, several European countries, now members of the European Union, expressed their willingness to join the organisation. In 1995, Cyprus applied for membership, but, according to the Cypriot government, it was vetoed by Turkey.

In 1996, Estonia, Latvia, Slovenia and Lithuania signed a Joint Declaration expressing willingness to become full members of the OECD.

In 2003, the OECD established a working group headed by Japan's Ambassador to the OECD Seiichiro Noboru to work out a strategy for the enlargement and co-operation with non-members. The working group proposed that the selection of candidate countries to be based on four criteria: "like-mindedness", "significant player", "mutual benefit" and "global considerations". The working group's recommendations were presented at the OECD Ministerial Council Meeting on 13 and 14 May 2004. Based on these recommendations work, the meeting adopted an agreement on operationalisation of the proposed guidelines and on the drafting of a list of countries suitable as potential candidates for membership. As a result of this work, on 16 May 2007, the OECD Ministerial Council decided to open accession discussions with Chile, Estonia, Israel, Russia and Slovenia and to strengthen co-operation with Brazil, China, India, Indonesia and South Africa through a process

of enhanced engagement. Chile, Slovenia, Israel and Estonia all became members in 2010. In March 2014, the OECD halted membership talks with Russia in response to its role in the 2014 Crimean crisis.
Costa Rica and Colombia both signed the accession agreement on 30 May 2018, and they will become full members after the ratification of the accession agreement and the deposition of the ratification document.
Other countries that have expressed interest in OECD membership in the last years are Argentina, Peru, Malaysia, Brazil and Croatia.

1.4 THE ORGANIZATIONAL STRUCTURE

The OECD organizational structure is a pyramidal one. On the top sits the Secretary-General, who manages the Organization and the budget. He is head of the Secretariat and have the power to elect and directs the workforce of the Organization. Since 2006 this role has been held by the Mexican Angel Gurría, who started his third five-year term in 2016. The General Secretary is assisted by the Deputy General Secretaries.
The decision-making body of the OECD is the Council, from which all the acts of the Organization came from, which has the task of defining the activities of the Organization, discussing and make a decision on the main policy issues, adopting binding decisions and recommendations.

The Council, who is chaired by the Secretary General, is made up of Permanent Representatives of the Member States and of the European Commission, the decision-making power is determine by consensus. They generally meet once a month for routine convention and once a year the meeting is convened at ministerial level and, for that occasion, is chaired by a Member State.

Italy held the presidency in 2010 and the vice-presidency in 2009. In 2019 the presidency was held by the Slovak Republic, with Canada and Korea as vice presidents.

In addition to the Board, the organizational structure includes:

- Three Standing Committees: The Executive Committee (composed of the Permanent Deputy Representatives), the External Relations Committee and the Budget Committee;
- Three Special Bodies established by the Board: Evaluation Committee, Audit Committee and Pension Budget and Reserve Fund Management Board;
- Over 300 committees, (e.g. first level bodies, and second level bodies (working groups, expert groups, task forces and forums), which depend on the committees.
- The General Directorates, which carry out all the activities in support of the Committees and subsidiary bodies.

The OECD also publishes books, reports, statistics, working papers and reference materials. Since 1998 those documents are published in a database that can be accessed via OECD iLibrary[2], a public online platform.

1.5 INTERNATIONAL OBJECTIVES

Since the goal of the international organization is to reach a worldwide sustainable economic scenario, the mission of the OECD is the promotion, at a global level, of policies that improve the economic and social well-being of citizens.

The Organization for Economic Cooperation and Development also play a crucial role in the political and scientific field, since it promotes the integration of the markets and the realization of the highest levels of economic growth and sustainable employment, through fostering investments and competitiveness while maintaining financial stability.

The OECD is aimed to create a strong connection within the government of member countries and the structures of research and elaboration of public policies. This allow the constitution of a prestigious forum for comparison, exchange and harmonization of national and international policies.

The IOs deals with different sectors such as the economic (competition, agriculture, business, services, local development and trade), the financial (financial markets,

[2] https://www.oecd-ilibrary.org/

insurance, pensions, investments, taxes, as well as transparency and tax cooperation), the social sector (education, work, health and migration), the governance (corporate and public reforms and the fight against corruption), the sustainable development (environment, energy, fisheries and sustainable development) ending up with technological cooperation and innovation (digital, biotechnology, ICTs).

The OECD therefore give a great importance to the activity of consulting and dialogue with organizations that represent society, since they influence the decision-making process of government policies.

The Organization has a set of tools to reach their objectives: The adoption of common principles; The constitution of binding agreements and Conventions; The publication (twice a year) of the Economic Outlook that helps to keep track of the global macroeconomic framework; The development of national and comparative studies; The country exams, conducted according to the "peer review" method; The definition of guidelines and coordination of development cooperation policies through the Development Aid Committee (DAC).

1.6 NATIONAL AND INTERNATIONAL LAW

Since international law is an independent system of law existing outside the legal orders of states, regarding the responses to international situation states usually

consider more relevant the international laws, and that's why we must clarify this actor.

Nowadays the range of subjects and actors directly concerned with international law is widened considerably. Although international law is a legal order and not an ethical one, it has been influenced significantly by ethical principles and the related concerns, particularly in the sphere of human rights.

There is no international body that create the public international laws since they are created by several sources. The establishing document is the "Charter of the United Nations" that was signed on 26 June 1945, in San Francisco, at the conclusion of the United Nations Conference on International Organization and came into force on 24 October 1945.

The purposes of this charter are mentioned its first article and are focused to maintain peace and security and to achieve international co-operation.

The document also introduces the International Court of Justice (ICJ) as the principal judicial organ of the United Nations. The Court has two main functions that are to settle, in accordance with international law, legal disputes submitted by States, and to give advisory opinions on legal questions referred to it by authorized UN organs and specialized agencies.

In the Article 38(1) of the Statute of the ICJ [3]that are listed the sources that the ICJ uses to resolve disputes as follow:

” The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply:

- International conventions. (whether general or particular) establishing rules expressly recognized by the contesting states;
- International custom as evidence of a general practice accepted as law;
- The general principles of law recognized by civilized nations;
- Subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.”

The second point of the article introduce the power of the court to decide a case “ex aequo et bono” if the parties agree thereto, in other word it’s a judicial decision to apply custom over the law.

Although considerable attention is given on violations of international law, states generally are careful to ensure that their actions conform to the rules and principles of international law, because acting otherwise would be regarded negatively by the international community. This could be reflected in international organizations and

[3] Charter of the United Nations, 1945

other actors which create a prejudice from the point of view of future relationship, since the system is sustained by reciprocity or a sense of enlightened self-interest. Moreover, the values of certainty, predictability, and sense of common purpose in international affairs derives from the existence of a set of rules accepted by all international actors. International law provides a framework and a set of procedures for international interaction, as well as a common set of concepts for understanding it.

1.7 OECD DUTIES IN MATTER OF TAXATION

As mentioned before, the architecture of the existing international systems goes back to 1920s from the seminal work of the League of Nations that allow the growth of the structure of the tax principles that we all know today: residence taxation, permanent establishments, reduced source taxation, credit and exemption methods for relief of still existing double taxation.

But these developments have been one-sided, since there is one important aspect of the early work that has been neglected.

The first model treaty, drafted by the League of Nations Committee of Technical Experts in 1927, explicitly acknowledged the single tax principle in its commentary, which states:

“From the very outset, [the drafters of the model convention] realized the necessity of dealing with the questions of tax evasion and double taxation in co-ordination with each other. It is highly desirable that States should come to an agreement with a view to ensuring that a taxpayer shall not be taxed on the same income by a number of different countries, and it seems equally desirable that such international cooperation should prevent certain incomes from escaping taxation altogether.”

Basically, from the most elementary principles of fiscal justice are based on a scheme whereby all the income is taxed once and only once. It’s right to say that that major part of the effort over the years from the international organization has been focused on making sure that double taxation doesn’t take place.

There are plenty of reasons on how things have developed this way in terms of tax competition, the part that are favoured by this pattern are countries which see structures that reduced the tax burden on their multinational enterprises in their activities abroad, but at the end, the effort on making sure that double taxation doesn’t take place result in a double nontaxation.

In 1998 the OECD released a report [4]on harmful tax competition that signalled an important change in matter of international cooperation efforts.

The report directly raised three distinct problems related to double nontaxation (or nominal taxation) on international income:

---

[4] Harmful Tax Competition, an Emerging Global Issue. OECD, 1998

- Tax evasion;
- Tax avoidance;
- Tax subsidies and ‘‘substantive’’ tax competition.

The most concrete results of that work have been in the area of tax evasion. International taxation is, by definition, the study or determination of tax on a person (or business subject) to the tax laws of different countries or the international aspects of an individual country’s tax laws as the case may be.

Basically, all the governments tax individuals and enterprises on income. Since there are no general international rules, the systems of taxation aren’t homogeneous. This variety could lead into double taxation, where the same income is taxed by different countries, and into double non taxation, where income is not taxed by any country.

Governments try to limit the scope of their income taxation in some manner territorially, or at least provide for offsets to taxation relating to extraterritorial income. The constraint takes the form of a territorial, residence-based, or exclusionary system. Some governments to restrain the different limitations that each of these systems of taxation create a hybrid system with characteristics of two or more.

The income tax systems usually impose tax on local income only or on worldwide income. Generally, where worldwide income is taxed, reductions of tax or foreign

credits are provided for taxes paid to other jurisdictions but, almost universally, some limits are imposed on such credits.

Multinational corporations usually employ international tax specialists (lawyers and accountants) to decrease their worldwide tax liabilities. Basically, what they do is shifting or recharacterizing income in some manner to reduce the total amount of taxes that a company must pay. Here raise the problem of our research, since basically any jurisdictions impose rules relating to shifting income among commonly controlled parties of the same entity, but with an old tax system and an increasing growth of digital world the only parties who win the "battle" of tax are multinationals, who are on step behind the tax authorities.

1.8 TAX SYSTEM FROM ALL OVER THE WORLD

Furthermore, the income is mainly taxed in two different form: The Territorial System and the Residence-Based System, respectively the first is the case where only local income is taxed which, by the definition, is the ones earned from a source inside the country. With this framework resident are fully taxed by the country tax code while non-residents are taxed only on income earned within the country.

The second system instead, occurs when residents of a country are taxed on their worldwide (local and foreign) income. Countries with this type of taxation usually

allow deductions or credits for the tax that residents already pay to other countries on their foreign income.

It's up to the countries tax authorities to determine which methodology utilize and why. Agreements among governments, called treaties, often attempt to determine who should be entitled to tax what and so try to eliminate (or at least reduce) the problem of double taxation. Most tax treaties provide a basic mechanism for resolution of disputes between the parties as we are going to see in our research.

To have a clear idea of the global picture of the kind of income taxation used in the world we refer to "Figure 1". In particular the light blue represents the Territorial system and the dark blue the Residence-based, while the green stands for countries with no income tax (on individuals) and the purple a Citizenship-based framework, as USA and Eritrea, who levies personal income tax regardless if they live in the country or abroad.

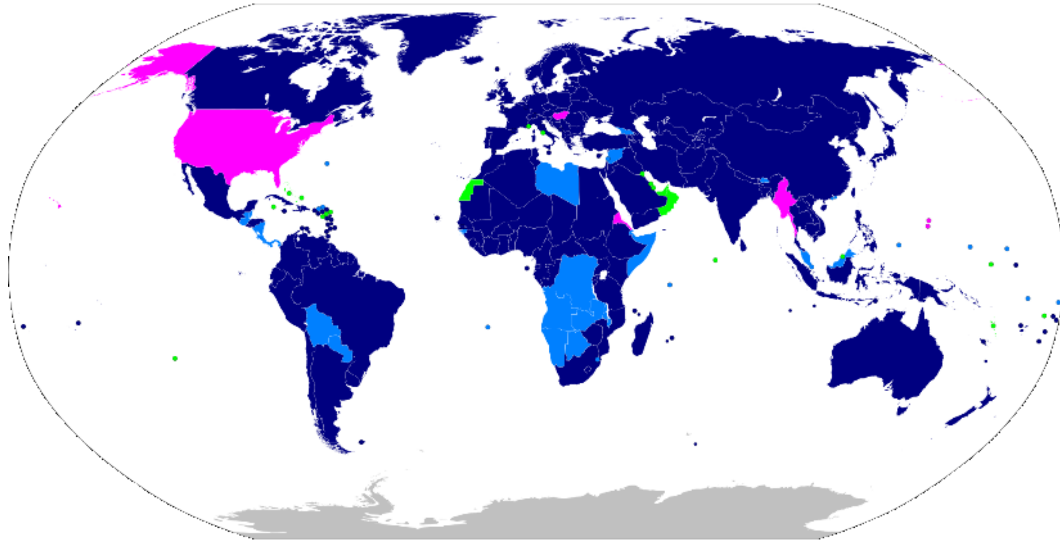

Figure 1. **Systems of taxation on Income**
Source: Wikipedia

Nonetheless since the rule is extended from individuals to companies the OECD develop a model to recognize which kind of income are subject to taxpayers of related parties.

To deal with the problem of “double non-taxation” the international organization has developed the Model Tax Convention, it is the basis for negotiation and application of bilateral tax treaties between countries, designed to assist business while helping to prevent tax evasion and tax avoidance. The model plays a crucial role in removing tax related barriers related to cross border trade and investment. The OECD Model also provides a way to resolve on a uniform basis the most common problems that arise in the field of international double taxation.

1.9 PLACE OF EFFECTIVE MANAGEMENT

Since countries do not necessarily use the same system of taxation for individuals and corporations, there is a strong need to classify the term “resident” of a contracting state and consequently to characterize the income of resident and non-resident.

For this purpose, we refer to Article 4 in the OECD Model Convention [5]which provides a tiebreaker rule for determining residence where an individual or a corporation is resident in two different countries.

Digging in the Article 4 of the OECD model we find in the first subparagraph the explanation of the term residence: “

1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein. “

[5] Model Tax Convention on Income and on Capital. OECD, 2017

Whereas the second paragraph provides guidelines for the problem of a dual residence, that means that an entity is both resident in two different states: "

2. Whereby reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:

   a) he shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);

   b) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode;

   c) if he has a habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;

   d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement. "

In address the issue of dual residence, the OECD Commentary further provides that all relevant facts and circumstances must be examined to determine the Place Of

Effective Management (POEM) because an entity may have more than one place of management, but it can have only one place of effective management at any one time as explained in the third subparagraph: "

3. Whereby reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated."

Basically, the residence of the entity is determined to be in the country in which its Place of Effective Management (PoEM) is situated. Furthermore, in the Commentary of the OECD, the "PoEM" is defined as the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made.

Although not officially intended, the term "effective" should be intended in the sense of the French "effective" which means "real".

What is important for our research is the fact that this article introduce the rule that reference is made primarily to national law but with guidance provided by the commentary of article 4 paragraph 3.

It's important to underline the factor of reference since every state, can choose which articles of the OECD model tax convention recognize binding in its national law. For example, in Italy only the article 4 is the only one acknowledgment in the constitution.

1.10 UPDATES NEEDED

The OECD Model requires constant review to address the new tax issues that arise in connection with the evolution of the global economy.

Working Party No. 1 of the OECD's Committee on Fiscal Affairs meets this need and its work results in regular changes to the model. Updates were published in 1994, 1995, 1997, 1998, 2000, 2003, 2005, 2008, 2010, 2014 and 2017.

In 2020 the model is expected to be renewed another time, this time the aim will be to prevent the formation of "tax haven" in correlation with the loopholes of the Article 4 of the OECD model. We are going to digging in those concepts in the second chapter.

As reported in the 2008 update[6] of the OECD model, "An entity may have more than one place of management, but it can have only one place of effective management at any one time". To identify where the PoEM is located competent authorities

would be expected to consider various factors, such as:

- The place where a company is managed and controlled;
- Where the meetings of its board of directors or equivalent body are usually held;

[6] OECD Commentary on Article 4, s.24.

- The place where the decision-making at the highest level on the important policies essential for the management of the company takes place
- The place that plays a leading part in the management of a company from an economic and functional point of view, where the senior day-to-day management of the business is carried on;
- Which country's laws govern the legal status of the entity,
- The place where the accounting records of the entity are kept;

Although model commentary does not provide meaning to the term PoEM, it provides illustrative list of factors which may establish a PoEM of a company in a country which is similar to the factors considered under the OECD Model Commentary.

The 2017 edition of the OECD is nowadays the "most updated" Model who mainly reflects a consolidation of the treaty-related measures resulting from the work on the OECD (G20) Base Erosion and Profit Sharing (BEPS) Project.

The 2017 update contains two main changes to Article 4 of the OECD Model tax convention. The most important for our research is the second one who deals with the tie breaker rule for determining the treaty residence of dual-resident individuals changed as a result of the final report on Base Erosion and Profit Sharing (Action 6.9). The Revised paragraph 3 of Article 4 states that in the case of dual residence, it's up to the competent authorities of the two countries endeavour to determine, by mutual agreement, the country of residence having regard to the PoEM, the place

where it was incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, paragraph 3 of Article 4 provides that "such person will not be entitled to any relief or exemption from tax provided by the treaty except to the extent and in such manner as may be agreed upon by the competent authorities". The Commentary on Article 4 further explains that countries should use the PoEM criteria as a tiebreaker rule in case of dual residence, countries could also include an alternative paragraph 3 which uses the PoEM as the tiebreaker in their treaties.

At this point is clear how multinationals, since the rapid growth of the economy that is going digital, can find loopholes in this old system to increase their profit by paying less taxes mocking the article 4 of the OECD model tax convention, that basically only states that a company has to pay taxes where the PoEM is situated. There is a long list of company legally sued for problems related to "tax residence" because with this scenario just by making some arrangements with hosting country, defined Advantage Price Agreement (APA), companies could decide in advance where the place of effective management is situated, exploiting different fiscal system and then moving the facilities. With an example we must reflect to this problem: The owner of a company can decide to pay the home income tax rate in nation A, that on average is 20%, or choose to move into a low tax jurisdiction nation B where, let's suppose, the income tax rate is set at 15%. Thus, is a legal

way that allow the owner of the company to save the 5% on income corporate tax. The answer to this dilemma is clear and that’s why things has developed this way. In a world in which the law should stay one step ahead the taxpayer, here goes the opposite. In the second chapter we are going to see how this happens with one of the biggest, and relatively young, company, that thought its journey shake once and forever the perception of the Law: Facebook Inc.

CHAPTER 2

2.1 COMPANY OVERVIEW

Nowadays everyone knows or have an account on Facebook, that is an online social media or social networking service company based in Menlo Park, California (USA).

It was founded in 2006 by Mark Zuckerberg along with others Harvard College students, the original idea was to connect university students living in the same area. It's now one of the big four technology companies along with Google, Amazon and Apple (GAFA).

The name comes from the "face book directories" often given to American university students. Facebook held its initial public offering (IPO) in February 2012, valuing the company at €95 billion, the largest valuation up to date for a newly listed public company.

The revolutionary idea was that the Facebook service can be accessed from any devices with Internet connectivity, such as personal computers, tablets and smartphones.

Just to give some insights about the social media itself, a user need to complete the registration, providing some personal information, to get access to the website and create a profile that receive information in the personal dashboard (called news feed). Furthermore, they can post text, photos and multimedia which is shared with

any other users that have agreed to be their "friend", or, with a different privacy setting, with any reader. Users can also use various embedded apps, join common-interest groups, and receive notifications of their friends' activities.

Facebook claimed that had more than 2.3 billion monthly active users as of December 2018. However, many critics questioned whether Facebook knows how many actual “real” users it has. The company faces big problem of fake accounts, as a matter of fact it caught 3 billion fake accounts in the last quarter of 2018 and the first quarter of 2019 all related with fake news, conspiracy theories and copyright infringements.

The social network growth is unprecedent, but despite the prominent media coverage, it includes many controversies that involve user’s privacy, as with the Cambridge Analytica data scandal, and political manipulation such as the 2016 United States elections.

The multinational is constantly active to face those issues, in particular to face the spread of false information and fake news in 2017, Facebook partnered with “fact checkers” from the Poynter Institute's International Fact-Checking Network to identify and mark false content, even though most ads from political candidates are exempt from this program.

2.2 FINANCIAL INSIGHTS

Facebook as a whole is not only a social network, since it offers different product and services. In recent years it acquired “Instagram”, “WhatsApp”, “Oculus”, and “GrokStyle” and independently developed Facebook Messenger, Facebook Watch, and Facebook Portal.

Despite the public scandal described before, the profits of the company registered a record in the annual revenue. In 2019 they registered €65,1 billion, a growth of 26,6% from the €51,4 billion of 2018 (37% increase from 2017). Even the net profit in that year increase by 20% (from 16,4 to 20,31 billion €). As we can see in “Figure2” advertisements represent almost all the social media revenue, in the third quarter of 2019 the holding reports a revenue of almost 17.000 million US dollars $ (€15.000 million).

North America is the fundamental market for Facebook, accounting for around 50 percent of total revenue, as a matter of fact is where the company holding is located. Also, the number of active users is growing, pointing out the fact that the site is not an economic bubble, but since his foundation and through different scandals the management respond well and keep pursue the willingness to remain one of the big four multinational company worldwide alongside Google, Apple and Amazon.

According to the website “hdblog.it” for 2019 the number of average monthly users is 2.32 billion meanwhile the daily is 1.52 billion, in both cases a growth of 9 percent compared to the previous year.

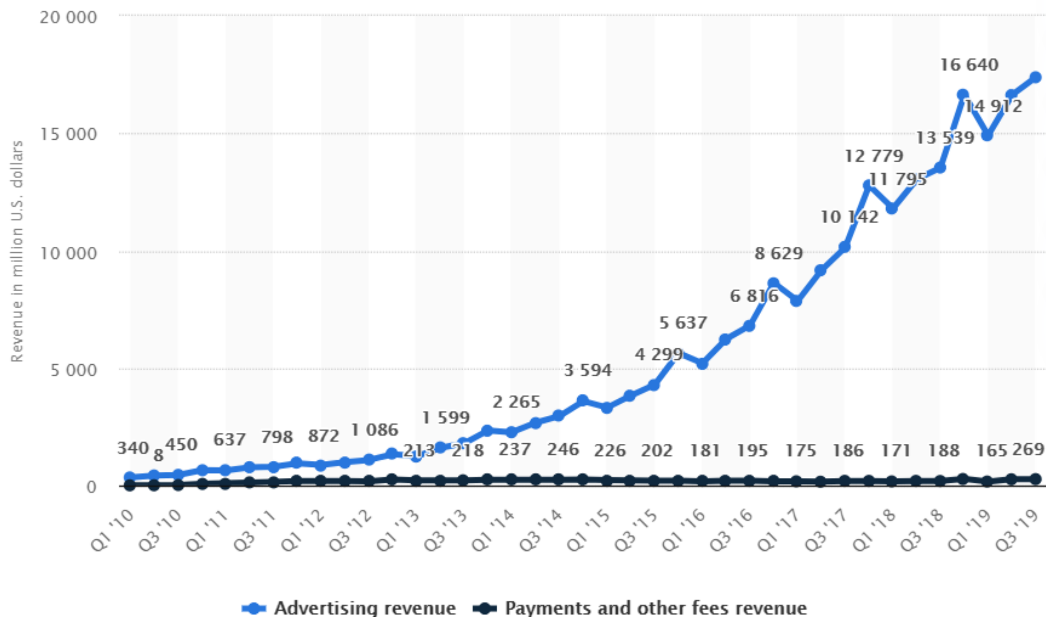

Figure 2. **Revenue of Facebook Inc.**
Source: statista.com

Facebook estimates that at least 2.7 billion people use at least one of the company's four services (Facebook itself, Messenger, WhatsApp and Instagram), and that at least 2 billion people use at least one every day. The company's employees have reached 44.942 people in 2019, an increase of 26,3% percent respect to 35.587 employer of 2018.

Google's dominance among search engines and Facebook's among social networks could be translated in the fact that there is an alarming trend towards monopolisation. Google and Facebook follow the same economic strategy since they operate with personalised advertising in different types of platforms and

consequently offer different information services, but use the same capital accumulation online advertising model, leading to a duopoly in the field of online advertising. In addition, these two corporations have avoided paying taxes, which is in most countries not illegal. There is a fine line between tax evasion and tax avoidance, and while there are dangerous consequences for tax evasion, smart tax avoidance techniques can be used to legally circumvent the rule and save huge amounts of money in taxes paid to the IRS. Sadly, while multinationals avoid paying the total amount of taxes that they have to pay, people suffer under wage stagnation and austerity measures evolve into cuts to public services. Global corporations amass huge profits generating a huge economic power that is further extended by tax avoidance that is, once again, tolerated by the states.

2.3 THE CASE OF FACEBOOK INC.

The key point that allow the fast growing of the multinationals is an innovative fiscal structure that allows to increase the profit of the company "just" by paying the minimum amount of taxes. The peculiar fact is that this strategy is pursued following the international e consequently national law, taking advantage of a loophole in the Ireland tax system.

In the United States domestic corporations are held to a worldwide tax, this means that they are taxed on all income, no matter if it's earned in the U.S. or abroad. This

leaves corporations seeking ways to reduce their tax liability. As you can imagine, companies like Google, Apple, and Facebook have huge profits to be taxed. The lower their tax liability is, the less tax they pay. In a utopic point of view, these domestic corporations have more money to spend on hiring and training their workforce and so invest into the overall growth of their companies.

Facebook Inc, the company based in the USA, is the ultimate holding of a huge number of worldwide subsidiaries. As reported in the website of the U.S. Securities and Exchange Commission, there are at least thirty subsidiaries based in three different continents such as Delaware in USA; Singapore in Asia and Ireland and Sweden in EU.

The company choose to have subsidiary in those nations because, among many different operational and logistic reasons, the Corporate Tax for companies that are resident is 27% in Delaware. Stressing out the art 4 (PoEM) of the OECD model which define that company must pay taxes where is given the ultimate decision of the management. But, at the same time, we have to mention that in the other location the Corporate Tax is respectively 17% in Singapore, 12,5% in Ireland and 21,4% in Sweden.

Furthermore, all those countries have a treaty, which is basically a written agreement, to avoid double taxation with the USA, that basically is exploited to choose where to pay taxes between jurisdiction.

In terms of corporate tax is now clear how is big the mismatch between Ireland and the other countries and that's why is not surprising that the fiscal strategy of the company is based there. Furthermore, to explain how the company exploit the loopholes in the Ireland tax system we must start from the bottom and explain the concept of subsidiary.

2.4 THE SUBSIDIARY GAMES

Why subsidiaries are so important? Simple: In the corporate world, a subsidiary is a company that belongs to another company, which is usually referred to as "parent" or "holding" company.

The parent holds a controlling interest in the subsidiary company, which means that it has (or controls) more than half of its stock. In cases where a subsidiary is 100% owned by another firm, the subsidiary is referred to as a wholly owned subsidiary.

There are three conditions for define a subsidiary:

1. The parent company own more than 50% of the stake
2. The composition of board of director is decided by the holding company
3. The company is a subsidiary of another subsidiary owned by the parent company

A parent company buys or establishes a subsidiary to provide the parent with specific synergies, such as diversified risk, or assets in the form of earnings and

equipment. But, at the same time for the law subsidiaries are separate, distinct legal entities for the purposes of taxation, regulation and liability. For this reason, they differ from the parent company, which is reflected in the independence of their liabilities, taxation, and governance. The consequence is crucial for our research because it means that if a parent company owns a subsidiary in a foreign land, the subsidiary must follow the laws of the country where it is incorporated and operates. Basically, a subsidiary is a business entity whose ownership and control are in the hands of another business enterprise (the holding).

This shake once and forever the definition of the Place of Effective Management of the OECD model, because basically with a subsidiary the multinational can "choose" where to pay taxes.

For the purposes of the case we focus our research in 5 subsidiaries located in Ireland that are:

- Facebook International Operations Limited
- Facebook Ireland Holdings Unlimited
- Facebook Ireland Limited
- FCL Tech Limited
- Runways Information Services Ltd

The subsidiaries, in addition to the fiscal advantages, ensured a way for transfer price to be applied.

Basically, transfer price is an accounting practice, and can be defined as: “the technique to move something between business unit (or division) in the same company that create value”. Transfer pricing allows for the establishment of prices for the goods and services exchanged between a subsidiary, an affiliate, or commonly controlled companies that are part of the same larger enterprise.

This operating procedure is nothing less than the price that one division in a company charges to another division for goods and services provided and can also be applied to intellectual property such as research, patents, and royalties.

The peculiar fact is that multinational companies are legally allowed to use the transfer pricing method for allocating earnings among their various subsidiary and affiliate companies that are part of the parent organization. But, at the same time, companies can also (mis)use this practice to manipulate their taxable income, this lead to a reduction of the overall tax burden, because the transfer pricing mechanism is a way that companies use to shift tax liabilities to low-cost tax jurisdictions helping the holding to reduce the tax burden.

On the side of the law, tax authorities have strict rules regarding transfer pricing to prevent companies from using it to avoid taxes.

In particular, the general rule for transfer price is defined by the Internal Revenue System (IRS), the body responsible for collecting taxes and administering the Internal Revenue Code in USA.

The regulations under section 482 states that “prices charged by one affiliate to another, in an intercompany transaction involving the transfer of goods, services, or intangibles, yield results that are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances”. In other words, the intercompany transaction must be treated in the exact same way as a sale to an outside customer, and this process is defined as “arm's length principle” (found in Article 9 of the OECD Model Tax Convention).

As a result, the financial reporting of transfer pricing has strict guidelines and is closely watched by tax authorities. Extensive documentation is often required by auditors and regulators. If the transfer value is done incorrectly or inappropriately, the financial statements may need to be restated, and fees or penalties could be applied.

Now, since the taxes are paid on profits, the huge difficulty for the tax authorities with large companies is trying to determine exactly what and how much is the profit.

Facebook under this view was criticized in early 2012, as reported in the article by Rupert Neate on The Guardian: “Facebook has become the latest multinational to come under the spotlight for its tax affairs after figures revealed it paid just £2.9m in tax on profits of more than more than £800m. […] Facebook is structured so that companies buying advertisements on the website in the UK, or anywhere outside

of the US, have to pay Facebook Ireland. This allowed Facebook Ireland to make gross 2011 profits of £840m (or £3.1m per each of its 287 staff)".

The article stressed out the fact that the taxes paid by Facebook were below the Irish corporate tax rate which itself is already one of the lowest corporate tax rates (12.5%) in comparison with other European countries. The Guardian report introduce us how, despite Facebook's high gross profits, an accounting method called "Double Irish" enabled Facebook Ireland to reduce its taxes to €3.2m in early 2011. This system makes use of royalty payments as tools to move substantial sums of money to other subsidiaries. It was used by Facebook to transfer almost €900 million to the Cayman Islands and its Californian parent in licensing and royalty payments through a thick series of worldwide bilateral treaties to avoiding double taxation. despite this, Facebook Ireland in that year reported an annual loss of €18 million even though 44% of Facebook's €3.42 billion revenues could be attributed to Facebook Ireland. Like Apple and Google, the author adds:" Facebook uses its Irish subsidiary to reduce its liabilities to HM Revenue & Customs and other European tax regimes. Amazon and Starbucks also cut their British tax bills by using the same technique via other European countries."

In the following paragraph we are going to digging in the Ireland tax scheme to find how Facebook use loopholes in the regulation, since there is much debate and ambiguity surrounding how transfer pricing between divisions should be accounted for and which division should take the brunt of the tax burden.

2.5 THE ATTRACTIVENESS OF IRELAND

Ireland is an island in the North Atlantic. It is separated from Great Britain to its east by the North Channel, the Irish Sea, and St George's Channel. Ireland is the second-largest island of the British Isles, the third largest in Europe, and the twentieth largest on Earth.

Geopolitically, Ireland is divided between the Republic of Ireland (officially named Ireland), which covers the main part of the island and is an independent state; and Northern Ireland, which is a constituent country the United Kingdom.

An important aspect to keep in mind is the fact that Republic of Ireland and the United Kingdom are members of the European Union, having both acceded to its precursor entity, the European Economic Community in 1973, and consequently there is free movement of people, goods, services and capital across the border. A similar agreement can be found between the British Isles such as United Kingdom, Ireland, Isle of Man, Guernsey and Jersey, since they made up a Common Travel Area for the almost free movement of people and goods and services.

The Republic of Ireland is a parliamentary democracy, with a written constitution and a popularly elected president who has mostly ceremonial powers. The government is headed by a prime minister, "*the Taoiseach*", who is appointed by the President on the nomination of the lower house of parliament, "*the Dáil*". Members of the government are chosen from both the *Dáil* and the upper house of parliament, "the *Seanad*". Its capital is Dublin.

The Republic ranks amongst the wealthiest countries in the world in terms of Gross Domestic Product (GDP) per capita, as a matter of facts in 2016 was ranked the sixth most developed nation in the world by the United Nations Human Development Index. After a period of rapid economic expansion from 1995 onwards became known as "the Celtic Tiger period", that ended in 2008 with an unprecedented financial crisis and an economic depression in 2009.

Nowadays the population of the whole Ireland is 6,71 million, composed by 4.83 million people living in the Republic of Ireland and the rest of them (1.88 million) in Northern Ireland.

In terms of GDP, which is the total expenditures for all final goods and services produced within the country in a specific period of time, the republic of Ireland registered €346,28 billion in 2018, an increase of 5.8% in comparison with the previous year. What the numbers don't say is the fact that Ireland's GDP is artificially inflated by BEPS accounting flows.

First thing first, The 1997 Tax and Consolidation Act, laid the framework for Base Erosion And Profit Sharing (BEPS) that on the opposite is aimed to contrast the corporate tax planning strategies used by multinationals to shift profits from higher to lower tax jurisdictions, thus eroding the tax base of the higher tax jurisdiction showing more cost (and so reducing the profit, or in other word the tax base).

To make some examples we must mention the “Double Irish” as used by Google and Facebook, the “Single Malt” as used by Microsoft and “Allergan and Capital Allowances for Intangible Assets” as used by Accenture, and by Apple.

This distortion escalated in the first quarter of 2015 when Apple executed the largest BEPS transaction in history, onshoring €276 billion of non-U.S. Intellectual Property to Ireland. This led to a huge increase in terms of GDP hidden by the Irish Central Statistics Office. Paul Krugman, the Nobel Prize winning economics, rename this scenario as “leprechaun economics”. It forced the Central Bank of Ireland to replace the Gross Domestic Product in 2017 with a modified gross national income (GNI), which removes part, but not all, of the distortions by BEPS tools, as a matter of fact the Irish GDP correspond to the 162% of Irish GNI in 2017.

The Ireland's “Offshore” is based on two main key elements. The first, dating from 1956, is a regime of low corporate tax rates and loopholes designed to encourage transitional businesses to relocate (often only on paper) in Ireland. The second element is the Dublin based International Financial Service Centre (IFSC), that is a deregulated financial zone set up in 1987. It hosts, and continue to do it, risky international banking activity allocating threats to global financial stability.

At this point is obvious why Ireland is so attractive, and we can't blame only the corporation tax rate set at 12.5% in 1999 by the Finance Minister Charlie McCreevy (reduced from 32%) in the Finance Act.

Furthermore, foreign multinationals pay an aggregate effective tax rate between the 2.2% and 4.5% on global profits shifted to Ireland, also thanks to the country's global network of bilateral tax treaties that facilitate the flow of money. The strategic position in Europe and a list of bilateral tax treaties with 70 countries in the world is another key factor that make Ireland so attractive for foreign multinationals.

Ireland is the leading location for the development, exploitation and management of intellectual property, and that's the reason why the main multinational tax schemes, that affect the BEPS movement, are based on Intellectual Property (IP).

According to the Industrial Development Authority (IDA) of Ireland, the number of global companies centralising their IP management in Ireland has made the island one of the largest exporters of it around the world.

Intellectual Property is a powerful tool for individuals and enterprises to help control their property rights since, by definition, it refers to the creations of the mind, such as inventions (patents); literary and artistic works (copyright); new product designs (industrial designs); and brand-names, symbols, or logos used to distinguish products and services from one undertaking from another (trade marks).

International companies generally adopt two different kind of structures for holding and managing IP out of Ireland.

The first structure is composed with an Irish company that hold the IP and claim a deduction for capital expenditure incurred on the acquisition or development of the

IP and the related interest expenses incurred. The profits of the Irish company will typically be subject to the corporation tax rate of 12.5% if the company has the requisite level of substance to be considered trading. At the end, the tax depreciation and interest expense can reduce the effective rate of tax to a minimum of 2.5%.

The second structure, that is the one used by Facebook Inc. is made with a foreign affiliate company that hold the IP and licence the use of it to another Irish company. In our case the affiliate is an Irish incorporated, but non-Irish tax resident, company that is resident in the Cayman Islands. The Irish company can take a deduction for royalty fees paid. There is also a wide range of exemptions from withholding tax on royalties paid to foreign companies. In conclusion, the profits of the Irish company will be subject to the corporation tax rate of 12.5% so long as there is enough activity and substance in Ireland.

Ireland is now searching for some strategy to deal with imposed end of the Double Irish and the two-pillar proposal from the OECD. The country is currently developing a "knowledge development box" similar to the United Kingdom "patent box" to reassure investors and US multinationals based in Ireland that the overall tax regime remained competitive. After a few months of turbulence and international scrutiny, tax experts said it was unlikely that the closing of the Double Irish would force Silicon Valley companies to move operations out of Ireland.

There is clearly something behind and it can be addressed as an "exchange of favour" between the state and some multinationals, since with the Double Irish the

country was able to growth in an exponential way basically choosing the less drastic path: collecting a small amount of money in taxes instead of nothing.

About the Ireland corporate tax system, BEPS Implementation is part of Ireland’s commitment to implementing the Anti-Tax Avoidance Directive (ATAD), the new budget 2020 further provide for new ATAD compliant anti-hybrid rules to apply to all corporate taxpayers from 1 January 2020. The purpose of those rules is to prevent arrangements that exploit differences in the tax treatment of an entity under the tax laws of two (or more) jurisdictions to generate a tax advantage.

2.6 THE DOUBLE IRISH

As reported before, there is a fine line between tax evasion and tax avoidance, and while there are consequences for tax evasion, smart tax avoidance techniques can be used to legally circumvent the loss of vast amounts of money in taxes paid to the IRS.

Since the begin of the century, multinationals are exploiting differences in national tax systems to adapt their tax strategies circumventing the law. A Task Force on Tax Planning Practices was established to investigate tax authorities signing Advance Pricing Agreements (APAs) in order to give Multinationals selective advantages and a beneficial treatment even before moving to a certain country.

Irish business leaders have been mistrustful of any move intended to close the Double Irish, in the absence of compensatory measures. The pattern just mentioned allows Ireland as a country to collect a huge amount of revenue in taxes even though the corporate tax is one of the lowest in the world, and despite the international pressure the Irish minister of finance Michael Noonan states that the rate never would be up for discussion.

To explain the fiscal strategy of Facebook we must go backwords in 2010, when the IP of Facebook Inc. were transferred to a subsidiary in Ireland, Facebook Ireland Holding Limited.

This was discovered by the U.S Department of Justice who filed a petition to turn over information to the Internal Revenue Service (IRS) about the transfer of asset to the Facebook's Ireland subsidiary.

The audit began in November 2011, and originally was only for the years 2008 and 2009, but a few years later, in 2013, the IRS expanded the examination to the subsequent financial year: The 2010.

According to court documents, Facebook produced thousands of pages of documents in response to more than 200 IRS requests. The audit largely targeted agreements between Facebook Inc. and Facebook Ireland's subsidiary transferring worldwide business rights to intangible assets declared to be worth only €6,5 billion. The Internal Revenue System aim is to determine whether Facebook's

outside accountants Ernst & Young identified in court documents have undervalued those assets.

This pattern lay the groundwork for a BEPS strategy known as “The Double Irish”, that has been exploited also by Apple company at the end of the 20th century.

This tax strategy is used by multinationals companies to reduce their tax liability, thus by shifting profits to a country with a lower-tax legislation. To increase profits, companies utilize transfer price techniques to implement the BEPS strategy that take advantage of the Irish system of territorial taxation. The double Irish strategy requires two Irish subsidiaries and draws on an exemption particular to Irish taxation law that in accordance with the article 4 of the OECD model, allows companies registered in Ireland to be taxed where their management is located. What is peculiar is the fact that this loophole in the Irish tax system exploited by Facebook permits the subsidiaries to be incorporate in Ireland but at the same time to declare their profits in tax havens, meanwhile remaining in compliance with EU jurisdiction.

To give some numbers to understand the proportion of this BEPS strategy we refer to an Article of the Financial Time of 2013 written by Jamie Smith: “A Dublin-based company at the heart of Facebook’s international tax structure used a complex tax avoidance scheme to limit its Irish corporation tax bill to €1.9 million last year, despite generating turnover of more than €1.7 billion Facebook Ireland Limited, which employed 382 people in Dublin, generated a gross profit worth

€1.75bn in the year to the end of December 2012. This profit turned into a pre-tax loss of €626,000 when the company paid Facebook Ireland Holdings Unlimited, its Irish-based parent company, €770m in administrative expenses for the use of intellectual property central to its technology platform. The parent company's annual report, which was filed recently with Ireland's Company's Registration Office, shows several of its shareholders are Facebook subsidiaries based in the Cayman Islands, which does not levy corporation tax. "

Thanks to this article we can explain how the Double Irish Is exploited by Facebook, an US domestic corporation that create in Ireland two subsidiaries: "Facebook Ireland Holding Unlimited" and "Facebook Ireland Limited".

The loophole is the fact that Irish law determine tax residency based on the country where the PoEM is located, and that's where this unique dynamic begins. "Facebook Ireland Holding Unlimited" is an Irish incorporated subsidiary under Irish law, but it's managed in the Cayman Island, a low-tax jurisdiction (or in other words Tax Haven). This company is treated as an Irish company by United States tax, but at the same time there's no tax under Irish law.

Then, there's a second company owned by the first: "Facebook Ireland Limited". This company is managed solely in Ireland, and it's crucial for the Double Irish pattern since the payments the company put on the books as royalties for the use of the first company's IP in Ireland (show cost in higher tax jurisdiction). Subsequently, the second company turns around and deducts the royalty payments

they made as a trading expense. All the income left over on the second company's end is taxed. What is peculiar is that the income is formerly taxed but, since the first company is in the Cayman Island, is taxed at the 0%. The country is known as tax haven, which have no corporate tax and represent ideal conditions for businesses to maximize their profits just by paying less taxes.

Back in the United States, the second company is treated as a disregarded entity for tax purposes, and both companies treated as Irish companies. The negligence of Irish policy on transfer pricing even exempts multinationals from paying fees on transferring their profits from Ireland to the tax haven.

In addition, as we can see in "Picture 3" a shell company located in the Netherlands can be used to transfer profits directly to the Irish company in the tax haven, extending the scheme to a double Irish with a Dutch sandwich. As the profits of the Irish company in the Cayman Islands will be taxed according to the corporate taxation rate of this tax haven country, this strategy essentially erases the tax burden of the received royalties.

The "game" is simple: Dutch has minimal taxes on outbound royalty payments (any EU country could be used). This company is added to avoid withholding taxes by licensing the first company's IP to it, and then the third company sub-licenses to the second company. The Dutch company is treated as a disregarded entity, and royalty payments between the second company and the Dutch company have no Irish withholding taxes payments made between EU countries can't be taxed.

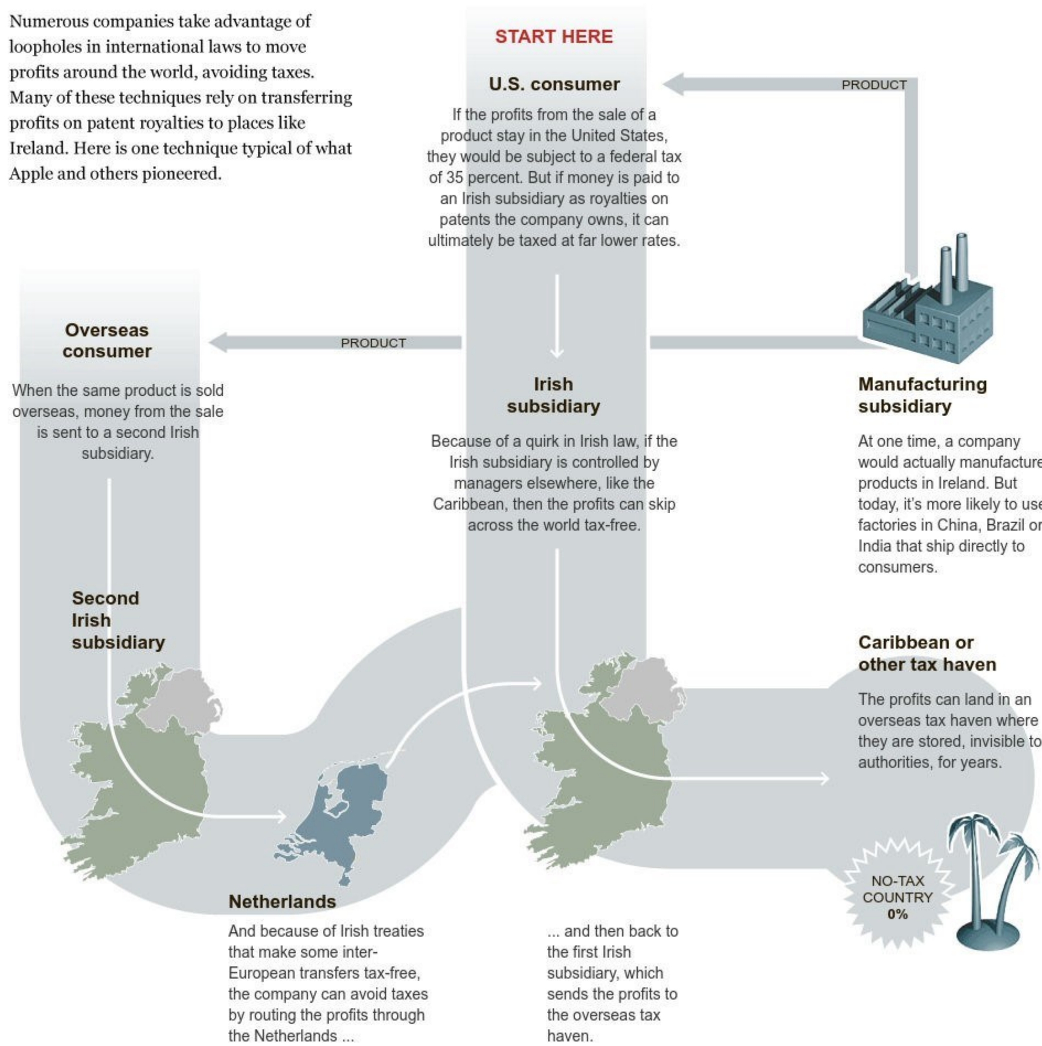

Figure 3. **The Double Irish (with a Dutch sandwich)**
Source: NY Times

2.7 PROSPECTS AND CONCERN ABOUT THE FUTURE

The Double Irish has attracted a lot of attention to Ireland, since is clearly a powerful tax strategy that is highly beneficial for the companies. However, it cannot be considered "unique" in the global context since several countries are known for offering business-friendly tax environments to attract corporations to their jurisdictions.

At the early stage of 2015 Ireland reformed its tax code with the "Irish Finance Act" to better adhere to international taxation standards. The legislative action includes, among the other things, the obligation for companies incorporated in Ireland to declare their profits as Irish tax residents. Furthermore, the Irish finance minister closed the loopholes above mentioned but at the same time granted a transitional period to find a new business arrangement until 2020 (a sort of *Vacatio Legis*). Unfortunately, the prospect is always the same with multinationals that are able to find another escape in the laws to protect their assets.

Since the 2008 financial crisis important authors such as Crivelli, de Mooij, and Keen in 2015; Cobham and Janský in 2018 have tried to estimate how much tax havens collectively cost to governments in terms of lost corporate tax revenue, through legal and not so legal system, and the answer is almost €500 billion each year.

Corporations aren't the only beneficiaries, according to Gabriel Zucman (2017), an economist at the University of California at Berkeley, individuals have hidden €8

trillion in tax havens. These highly uncertain estimates are due to the financial secrecy which is reflected in partially incorrect official data. Furthermore, there’s no generally accepted definition of a tax haven: it can be identified because it fulfils two words: “escape” and “elsewhere”. Because the main corporate users of tax havens are large financial institutions and other multinationals, the system put in danger small and medium enterprises, boosting monopolization.

Trying to give some numbers for the proportion of this problem we referred to figure 4: a graph created with data from the official website of the OECD. The indicator is related to governments considered as a whole (all government levels) and is the output of the total tax revenue, calculated as a percentage of GDP, which indicates the share of a country's output that is collected by the government through taxes. It can be regarded as one measure of the degree to which the government controls the economy's resources. The average (AVG_OECD) is 34,3% while some countries as Italy, France and Belgium are above that level with a least 42% of tax revenue. The USA is far lower from the threshold and it can be addressed to the new tax code proposed by the Republican parties (GOP) of 2018 where tax rate was set fixed at 21% instead of a flexible one starting at 15% and rising to 35% on taxable income over a threshold of €10 million.

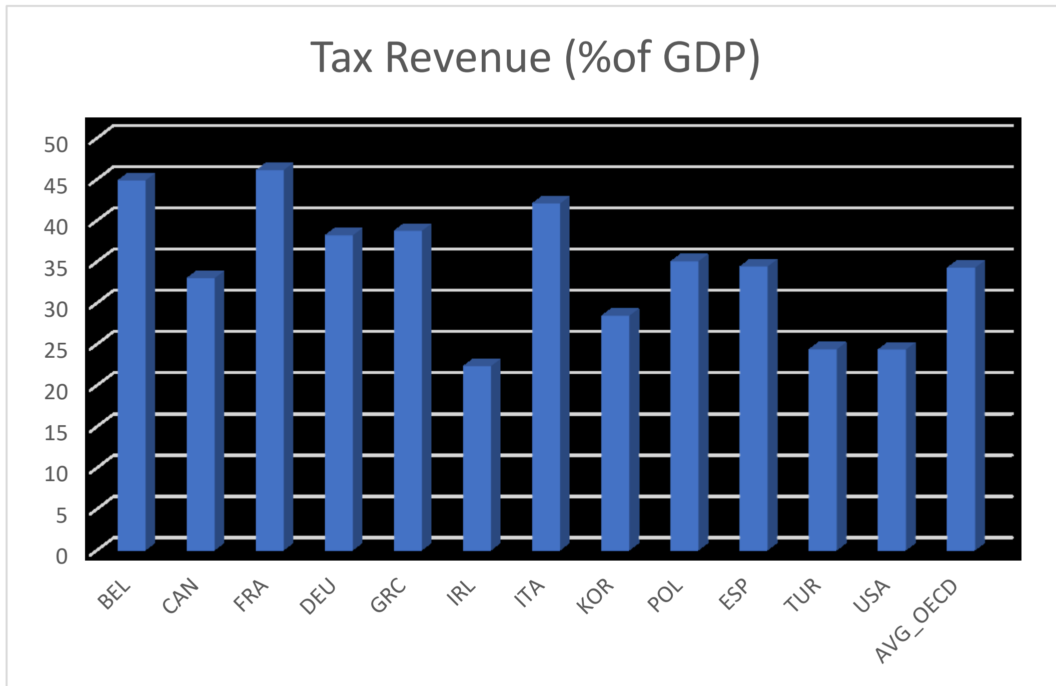

Figure 4. **Tax Revenue (%of GDP)**
Source: Oecd.com

The tax bill is also changing how the tax authorities deal with overseas profits: Multinational companies currently pay US taxes on income earned abroad. But, with the new plan, the code is changing towards territorial system, making companies responsible for income earned in the US. It also creates new rules to prevent companies from unfairly taking advantage of the shift. The plan also imposes one-time, ultra-low tax rates for corporate profits currently being held offshore, charged at 15.5% on liquid assets and 8% for illiquid assets. It's being described as the biggest single drop in corporation tax in US history.

The OECD’s overall tax-to-GDP ratio, meanwhile, remained relatively unchanged between 2017 and 2018, from 34.2% to 34.3%. For 2019 the scenario isn’t changing and is expected a little growth up to 34,6% according to recent studios.
Tax avoidance is a form of tax non-compliance different from tax evasion in which the tax liability is reduced in a legal way, based on the pattern above mentioned. However, the line distinguishing between ‘unacceptable avoidance” and “legitimate mitigation’ is highly debatable.
The practice of Double Irish underlines the constant profit maximization in international corporations and the crucial role that have national tax systems and the related loopholes in corporate strategies.
An important aspect to mention is that beside multinationals that behave in this way for the maximization of their fiscal strategy, at the same time also countries are competing for economic “attractiveness” in their legislations, but International pressure driven by the OECD with BEPS measures starts to limit informal economic activity and reduce the magnitude of tax avoidance, as suggested by the agreed ending of the Double Irish practice by 2020.
We are now at the start of the most significant period of change to the international corporate tax system in a century. In January 2019 for the first time, the OECD admitted publicly a need for “solutions that go beyond the arm’s length principle.” In March, Christine Lagarde, managing director of the International Monetary Founds (IMF), called the method “outdated” and defined it extremely dangerous

for the low-income countries. It's clear now how an update of the model is needed, starting from the model of Facebook that shake once and forever the international tax system arriving to think a solution for taxing that goes beyond the simple world "residence" as stated in article 4 of the OECD model convention. There is a famous statement to understand how much we cannot rely anymore on residence in matter of taxation: "Airbnb does not possess real estates, Alibaba does not carry inventory, Booking.com does not own any hotels and Twitter and Facebook do not produce content ".

In the following chapter we are going to digging into the concept of "digitalization" trying to explain how much it affected the international tax system, starting from the early moves of the OECD to fight against the BEPS until we get to the situation nowadays.

CHAPTER 3

3.1 DIGITALISATION

Digitalisation is the key aspect of the third and last chapter. The issues start even with the definition, since there isn't a common one. According to the International Monetary Funds (IMF) the digital economy is defined as online platforms and related activities fundamental for their existence. In a broad sense the definition summarizes all activities that use digital data.

The digital economy is growing exponentially with the rapid diffusion of related technologies, as a matter of fact nowadays the entire economy is going digital (for 2020 is expected 30 billion connected device). These factors as well as innovations and machine learning are transforming and 'digitalising' traditional sectors such as retail, manufacturing, health care and car industry.

The phenomenon of digitalisation comes out with the World Wide Web 25 years ago, shaking once and forever the existing industries by changing the nature of innovation, product development along with interactions between producers and consumers.

If on one side states could take advantage of the huge opportunities generated by this new economy, on the other side they have to face new challenges caused by it. Nowadays the increasing predominance of tech companies is unstoppable, as a matter of facts, the cumulated turnover in 2019 of GAFA (Google, Apple,

Facebook, Amazon) corresponds to the average Gross Domestic Product (GDP) of a State. The trend is clearly toward monopolization since 9 “big tech” companies own the 58% shares of the market.

Basically, only after scandals like “LuxLeaks”, “Panama Papers” and “Paradise Papers” where digitized confidential files (at least 11.5 million documents) providing detailed information on more than 214.000 offshore companies have become of public domain. The investigations from Europe finally starts involving major multinationals, including digital tech giants, bringing the attention of the world on a wide range of tax evasion schemes commonly used from multinationals. According to the European Tax Commissioner Pierre Moscovici digital companies pay an average of 9% effective tax rate in the EU and compared to the fact that other firms pay an average of 21% shows us how much the international tax system is outdated in matter of digitalisation. For these reasons’ governments, also experiencing political and media pressure, felt compelled to ensure that digital companies pay their fair share of tax where their profits are generated.

Furthermore, the new features of the digital economy are aggravate the BEPS risks causing more challenge for tax policy, such as: lack of nexus (the principle of establishing the connection that a business has with a given jurisdiction), reliance of intangibles, data and user-generated content, income characterisation, spread of new business models, in which the buyer and seller are in different jurisdictions, and the expansion of e-commerce.

This bring us to explain how the situation has developed this way, starting from 2015 when for the first time the problem of “going digital” enter in the International law.

3.2 THE ACTIONS

As reported before, the OECD starts only in October 2015 to address problems of digitalisation and the related tax challenges raised for the economy, identifying them as one of the main priorities of the Base Erosion and Profit Shifting.

With the first official report[7] of BEPS “Addressing the challenges of the digital economy” The OECD made the first Action (Action 1) in the fight against BEPS, a first approach to gain more insight into the development of the digital economy.

The report on Action 1 signalled a 15-point Action Plan to address the BEPS issues and concludes with the assertion that the digital economy cannot be ring-fenced and separated from the rest of the economy, since it represents a measure of the economy itself. However, it also states that the current fiscal system is clearly not capable of entirely tax the income generated by the multinational that operates in the digital sector. Therefore, the development of an appropriate tax framework for the digital economy is the highest priority issue that needs to be solved.

[7] Action Plan on Base Erosion and Profit Shifting. OECD, 2015

The characteristics of this new economy require a more general approach, that focus on the correct allocation of tax among different jurisdictions.

The latter challenges, however, were acknowledged as going beyond BEPS, and were described as chiefly relating to the question of how taxing rights on income generated from cross-border activities in the digital age should be allocated among jurisdictions. Given the considerable divergence between the physical place where the sale of digital goods and services occurs and the taxation of the relative income, it is necessary to take into consideration forms of taxation that goes beyond the actual norms (the Article 4 of the OECD) that identified the presence of a taxable income only if there is a permanent establishment.

However, the suggestion made are widely debatable and can be summarized in three options to address direct tax challenges raised by digital economy:

- **Scale without mass.** As we see through the Facebook cases, digitalization has allowed companies to distribute the production process in different countries and, at the same time, to be involved in a jurisdiction regardless the physical presence. The new dynamics allow business to be virtually conducted without any physical presence, lead some difficulties for the tax authorities to determine the jurisdiction eligible for taxation.
- **Reliance on intangibles,** especially as far as intellectual property is concerned. For many digital enterprises the intensive use of IP assets, such as software and algorithms that support web-based platforms, is

fundamental to their business models. This pattern on one side increase the ability of company to structure themselves to minimize their tax liabilities; and on the other side arose problems for tax authorities in the valuation and allocation of the income from such assets amongst different parts of multinational groups.

- **Extensive data and users-generated content**: It raises the question on whether the users contribute to value creation by providing voluntary their data to platforms (often in exchange of free access) which is then sold to online advertisers by platforms.

In addition, new business models and new delivery channels makes the characterisation of income between business income (subject to corporate tax on net income) and royalties/technical services (subject to withholding tax on gross income) becomes extremely difficult.

The report also discussed indirect tax challenges generated by e-commerce, recommending that countries should apply the principles of the OECD's International Value Added Tax and Goods and Services Tax (VAT/GST) Guidelines. In conclusion, some possible solution to address these concerns were identified, but none of them were agreed (or recommended) as part of the BEPS package.

3.2.1 THE INCLUSIVE FRAMEWORK

The final discussion for the evaluation of the report should have been mandatory for 2020, but, since the concern about the exponential growth of digital economy, the OECD decided in March 2017 to establish the 117-Member Inclusive Framework on BEPS: a system of monitoring and peer review working through its Task Force on the Digital Economy for an Interim Report[8].

The report was published in the OECD official website on the 16th of March of 2018 under the name of "Tax challenge arising from digitalization" (and its Policy Note on 23rd January 2019). The objective is to study international nexus and profit allocation concepts for taxing the digital economy.

The work of the Inclusive Framework has focused on the examination of a number of proposals that seek to revise contemporaneously the existing profit allocation and nexus rules, which allocate more taxing rights to the country where the customers and/or users are located (so-called "market country") instead of the one based on POEM and Permanent Establishment.

The Interim Report also repeated the conclusion from the Action 1 report that it would be difficult, if not impossible, to isolate the digital economy from the rest of the economy. While members of the Inclusive Framework did not agree on the conclusions drawn from this analysis, they committed to continue working together

[8] Tax Challenges Arising from Digitalisation, Interim Report. OECD, 2108

on the development of a consensus-based long-term solution by 2020, with an update in 2019.

The report is important for our research since it provides a deep analysis of new business models and value creation, countering aggressive tax planning schemes, such as the "Double Irish" of Facebook, meanwhile multinationals are changing their cooperative structures and moving to local distributor models referred to as "on-shoring" of Intellectual Property.

Acknowledging that more time is needed to evaluate the impact of the BEPS Actions, the report discusses the progress made by the OECD recommendations, especially BEPS Action Points, which are the most relevant to the digital sector. These include 4 minimums standard that are subject to peer review in order to ensure timely and accurate implementation.

These four minimum standards approach the problem of taxation overcoming the Article 4 of the OECD model, that states that company must pay taxes where the Place of Effective Management is located. Those actions are aimed to end the era of "tax avoidance" starting to split the cake of taxation among the different nations involved in the process, in order to ensure that all the taxes are paid (in correct jurisdiction) and not only a symbolic amount.

The four minimum standards are Action 5 on Harmful Tax Practices; Action 13 on Country by country reporting; action 6 on treaty abuse and action 14 on Dispute Resolution. But let's see how they are so important.

3.2.2 HARMFUL TAX PRACTICES

The aim of action 5 is to restructure the work on harmful tax practices, increasing transparency and highlighting the substance of transactions, as well as using shared methodologies in setting minimum standards to be respected in order to benefit from favourable schemes. This would lead to a compulsory exchange of information between countries on decisions concerning the subsidised schemes in force and related procedures.

Basically, the work is focused on taking down beneficial treatment from Intellectual Property regimes replacing them with substantial activities resulting from R&D. This new pattern in conjunction with the modified nexus approach that ensure a spontaneous automatic exchange on tax rulings, will end situations like the Irish one that allow the framework of the Double Irish described in the second chapter.

Post BEPS, multinationals would have to move their R&D activities to the jurisdiction offering a favourable patent box. Attracting R&D is more beneficial to the economy than merely attracting Intellectual property, that's why Ireland even after the shame for its Double Irish Dutch Sandwich schemes, remains an attractive location. Although from January 2015, the country enacted laws to treat all companies incorporated in Ireland as a resident, the Minister of Finance put in place a knowledge development box in line with the OECD's modified nexus approach for Intellectual Property tax regimes, providing for a 6,25% effective rate of

corporation tax on qualifying profits related to qualifying Intellectual Property assets.

In October 2017, the OECD released a progress report on preferential regimes, which was updated on 9 May 2018. According to the report among 175 tax regimes, 31 have been modified and 81 undergo legislative amendments.

3.2.3 COUNTRY-BY-COUNTRY REPORTING

The action 13 is what are more important for our research, since before that in matter of transfer price and relative documentation a multinational like Facebook Inc. with the "games of subsidiaries" explained before, constantly hide the physical presence in different countries. So, at the end they of the journey, they just have to keep (and show) public records only where is located the ultimate holding company that pays taxes.

BEPS action 13 named "*Transfer Pricing Documentation and Country-by-Country Reporting"* is basically a template for multinational enterprises that allow to report each year information about profit, sales, number of employees, assets and income tax for a clear overview of each tax jurisdiction in which multinationals do business. This avoid the problem of the lack of information, usually hidden for all the states except for where the holding company is located. To facilitate the implementation of the CbC Reporting standard, the BEPS Action 13 report includes a CbC

Reporting Implementation Package. It consists of a model legislation that could be used by countries to require the ultimate parent entity of a multinational group and to ask to file the CbC Report in its jurisdiction of residence including backup filing requirements. The model also provides three model Competent Authority Agreements that could be used to facilitate implementation of the exchange of CbC Reports, respectively based on the Multilateral Convention on Administrative Assistance in Tax Matters; Bilateral tax conventions; and Tax Information Exchange Agreements.

The results of Action 13 are that currently 90 jurisdictions have law in place introducing a CbC reporting obligation. The first exchanges of CbC reports took place in June 2018 and, with the OECD's support, tax administrations are incorporating CbC reports into their tax risk assessment and assurance processes to understand better the risks posed to their jurisdictions.

3.2.4 TREATY ABUSE

Over the last decades bilateral tax agreements have served to prevent harmful double taxation and remove obstacles to cross-border trade in goods and services, and movements of capital, technology and persons. This extensive network of tax agreements has, however, also given rise to treaty abuse and so-called "treaty-shopping" arrangements.

This practise involves the attempt by a person to indirectly access the benefits of a tax agreement between two jurisdictions without being a resident of one of those jurisdictions. Treaty abuse is one of the most important sources of BEPS concerns. The results so far show that the first peer review on the implementation of the Action 6 minimum standard reveals that a large majority of Inclusive Framework members have begun to translate their commitment on treaty shopping into actions and are now in the process of modifying their treaty network. In total, on 30 June 2018, 82 jurisdictions had some treaties that were already compliant with the minimum standard or that were going to shortly comply.

3.2.5 DISPUTE RESOLUTION

BEPS Action 14 seeks to improve the resolution of tax-related disputes between jurisdictions. Inclusive Framework jurisdictions have committed to have their compliance with the minimum standard reviewed and monitored by its peers through a robust peer review process that seeks to increase efficiencies and improve the timeliness of the resolution of double taxation disputes.

The report on BEPS Action 14 (*Making Dispute Resolution Mechanisms More Effective*) contains a commitment by jurisdictions to implement a minimum standard to ensure that they resolve treaty-related disputes in a timely, effective and efficient manner. All members of the Inclusive Framework on BEPS (IF) commit

to the implementation of the Action 14 minimum standard which includes timely and complete reporting of mutual agreement procedure (MAP) statistics pursuant to an agreed reporting framework

3.2.6 OTHER BEPS ACTIONS

Other important BEPS action that are suggested in the Interim Report that should be mentioned in our research are Action 7 on Permanent Establishment (PE), which are currently slowly implemented by the Multilateral Convention. According to Article 7 of the OECD's Model Tax Convention, companies can only be taxed at the state of residency if the business is conducted through a PE. This outdated concept is no longer valid due to the emergence of the digital economy, which is increasingly based on trade of goods and services electronically, without the need for a physical presence in a jurisdiction.

There are also been implemented new transfer pricing rules aimed at ensuring that transfer pricing outcomes are in line with value creation through Actions 8-10 on Transfer Pricing.

The driven fact is that legal ownership will not imply an unconditioned right to profits connected to the assets because such rights will depend on functions. This should make it more difficult for global players to stream large parts of the profits related to IP from high tax jurisdictions to low tax jurisdictions.

Following this rationale, some companies may adapt their practices to the requirements of the revised OECD Transfer Pricing Guidelines on control of risk and performance.

Action 3 on Controlled foreign company (CFC) rules respond to the risk that taxpayers can strip the tax base of their country of residence and by shifting income into a foreign company that is controlled by the taxpayers. Without such rules, CFCs provide opportunities for profit shifting and long-term deferral of taxation.

Eventually, new Guidelines and Implementation Mechanisms relating to Value Added Tax were added and the Guidelines were adopted by 50 jurisdictions.

Even though those action are the most relevant to the digital sector to fight against BEPS and have a proper allocation of taxing rights, Action 7, Action 8-10 and Action 3, are proved inadequate to tackle more fundamental long-term issues, as they fail to address key problems of nexus, profit allocation and separate group entities.

3.2.7 GENERAL EVALUTATION OF BEPS

There were raised question about whether the project is more for political effect than substantial reform. Basically, the BEPS was instrumental in drawing attention to international tax issues, due to their technical nature.

Since the necessity of a radical reform in the fiscal system we can say that the BEPS action undertaken (until now) are only superficially addressing the issues that are troubling the system, including economic inefficiency and instability due to tax competition.

The main important changes introduced by the project and the relatives actions was the implementation of those four minimum standards: Action 5 on harmful tax practices, Action 6 on treaty abuse, Action 13 on CbCR and Action 14 on dispute settlement (even if classified at minimum standard, the Action 14 was not even aimed against the BEPS).

However, it’s fair to say that not all the most relevant actions aimed to take down the tax avoidance of the digital sector become minimum standard.

We must once again underline that the key factor which allows the begin of the tax avoidance journey is the separate entity principle, which enable multinationals to easily reallocate functions, assets and risks to low-tax jurisdictions through a controlled company, in such a way to maximize sales, revenue and profit.

Same as before, multinational continue to reassess their structures in line with the new rules to meet the new requirements and it’s fair to say that until now, a few real changes have been made aimed to fight the separate legal entities principle.

Nonetheless, tax planning potential would not diminish because one allocation criterion (contractual risk allocation) has been replaced by another (people functions) that is also subject to manipulation.

Although is still early to evaluate the impact of the BEPS measure introduced by the interim report, some actions such as new transfer price guidelines, lower threshold for Permanent Establishment, more limited possibilities to rely on favourable regimes and tightened anti-abuse rules start influencing the way multinationals organise their business activities.

According to the rationale of tax expertise Andersson the changes following Action Point 7 on PE and Action Points 8-10 on intangibles does not "adequately address taxation of digital platforms and businesses providing goods and services in countries without, or with limited, PE presence."

Thinking about the Permanent Establishment, the changes introduced to Article 5 are not enough to fight the source versus residence dilemma, as connecting links when it comes to cross-border trade, in the new digital world.

In order to constitute a Permanent Establishment, an entrepreneur would still need to have human and technical resources and there should be a place of business with a certain degree of permanence. Hence, the actual source-revenue effects are likely to be minimal because BEPS measures are based on physical presence, which are not relevant to the digital economy.

Furthermore, there is no evidence whether the broader tax challenges mentioned in Action 1, such as nexus, data and characterisation, have been tackled or not due to the change of tax planning practices. Despite this, little progress was achieved in Action Points, which are most relevant to the digitalisation.

3.3 THE PHYSICAL PRESENCE PROBLEM

One of the focal points of dissatisfaction relates to how the existing profit allocation and nexus rules take into account the increasing ability of businesses, in certain situations, to set up in a specific jurisdiction without a relevant physical presence. The growing up reliance on intangibles and the rising share of services in cross border trade are the principal causes identified.

The global dissatisfaction leads to a political imperative to act in a significant number of jurisdictions starting to move something. Furthermore, the Inclusive Framework is therefore concerned that a proliferation of uncoordinated and unilateral actions by member states will impact investment and growth, since predictability and stability are the milestone for the global economy.

The sustainability of the international framework for the taxation of cross-border business activities are in danger, that's why it is necessary to change international corporate taxation in which countries only have a right to tax activities from companies that have a physical presence on their soil. It should be clear now that the old article 4 of the OECD model tax convention is jeopardising the stability of the fiscal system.

In recent years, the OECD proposed that countries should have a right to tax a proportion of the global profits of highly profitable multinationals wherever these might have been shifted around the world. After months of silence in October 2018 in a convention the secretariat Angel Gurria admit that "In a digital age, the

allocation of taxing rights can no longer be exclusively circumscribed by reference to physical presence. Emerging and developing economies would gain taxing rights over these companies for the first time because although the multinationals sell and market products widely in their jurisdictions, they often have no physical presence". This speech preannounces the imminent publication of the "Programme of Work" developed by the OECD to shut down forever the issue generated by article 4.

3.4 THE PROGRAMME OF WORK

The work of the Inclusive Framework continued with the publication in January 2019 of a brief Policy Note [9]"Addressing the Tax Challenges of the Digitalisation of the Economy", which summarises the path undertaken at international level in terms of the digital economy. In the Policy Note, the OECD acknowledges how the process of digitization of the economy is a growing phenomenon that generates complex problems involving also companies that are not highly digitalized.

The Inclusive Framework agreed to examine and develop different proposals on a "without prejudice" basis to reach global consensus. Those proposal can be broadly summarized into two pillars:

- Pillar One focuses on how existing rules, which grant the right to tax multinational companies' income between jurisdictions, could be changed

[9] Addressing tax challenges of the Digitalisation of the Economy. OECD, 2019

in response to changes that digitisation has brought to the economy. It focuses the attention on the allocation of taxing rights, and seeks to undertake a coherent and concurrent review of the profit allocation and the new nexus rules because the “significant economic presence”, which was discussed in Action 1, is overcome by “significant digital presence”

- Pillar Two focuses on the remaining BEPS issues and seeks to develop rules that would provide jurisdictions with a right to “tax back” where other jurisdictions have not exercised their primary taxing rights, or the payment is otherwise subject to low levels of effective taxation. The OECD further clarifies that this proposal does not change the degree of freedom of countries or jurisdictions to set their own tax rates or not to apply any taxation to corporate income.

This ongoing work should put the world “end” into the controversial ideas and proposal discussed among members of Inclusive Framework, and it’s further realized with an effective creation of a Programme of Work from the OECD

3.5 A FRESH NEW START

The next step was taken with the "Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy"[10]

[10] Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the

published by the Inclusive Framework on 31 May 2019 which underlined the need to achieve a Unified Approach by January 2020 and to reach a consensus solution by the end of 2020. The Programme Work focuses on the two pillars already outlined in the January Policy Note: while the first pillar concerns the allocation of taxing rights and a coherent and shared review of profit sharing and nexus rules, the second focuses on the remaining BEPS issues.

The Programme of work define the modalities through tax profit generated by cross-border activities in the digital age: the new rule is based on the "active and participatory user bases" in which the physical presence is not the only thing to consider to define the residence of the company in a specific jurisdiction.

This mechanism is applicable with reference to specific business models such as social media platforms, search engines and online sales platforms. In particular it is applicable to any company that, while operating through a minimal physical presence on the territory, makes a profit related to intangibles (e.g. brands, customer data).

Finally it arrives also the new proposal in matter of physical presence: it was introduced the concept of "significant economic presence", despite the old physical presence the new proposal is determined with new factors such as: the volume of

---

Digitalisation of the Economy. Inclusive Framework on BEPS, 2019

digital content, the existence of a local language website and the promotion activity carried out online to attract customers.

3.6 THE UNIFIED APPROACH

The perfect outcome of the pillars in the Programme of Work lead to the "Unified Approach"[11] which consists in a series of measures aimed at redistributing the power of taxation among States, through different criteria.

The OECD proposal seeks to develop an approach based on the proposals of the Programme of Work, that should be shared by all members of Inclusive Framework and it will include three elements:

- Scope of application. This would apply to businesses providing digital products or services with a "consumer-oriented" element (such as digital platforms). The new rules are based on the awareness that in an increasingly globalised and digitalised modern economy, businesses can interact with the consumer regardless of the traditional physical presence in the market;
- New definition of nexus. Currently a non-resident business can only be taxed if it has a permanent establishment in the foreign state. It's clear by now that digitisation jeopardises the applicability of this rule. That's why the proposal provides a new concept of nexus based on sales, companies

[11] Secretariat Proposal for a "Unified Approach" under Pillar One. The inclusive framework, 2019

could therefore be taxed in each country if they reach a certain sales threshold in specific jurisdiction: “significant digital presence”.

- New profit reallocation rule. The proposal aims at creating a new profit-sharing rule while maintaining the current transfer pricing rules based on the arm’s length principle. Once it is established that the right to tax the profits of a non-resident company are attributable to a specific country, the portion of profits attributable to that jurisdiction must be determined.

In the Consultation Paper, the OECD states that most tax disputes for large groups of multinationals regards the practical application of the provisions in matters of marketing and distribution activities. Under the new rules provided, companies have a percentage of their income taxed in jurisdictions where is located the market or the consumers. This new redistribution allows all states involved to tax a share of the profits that multinational companies make without any physical presence. Furthermore, the share is calculated through a formula based on the results of consolidated financial statements, as well as a predetermined rate of return for distribution activities. The new rules are following the existing transfer pricing rules, but at the same time establish (in a simple way) how to distribute the profit generated by companies between different jurisdictions, avoiding risks of double taxation and tax uncertainty.

Furthermore, it is necessary to coordinate these new rules in order to avoid distortions in the tax system that result in creation of unilateral measures from countries, as we are going to see in the next paragraph

3.7 COUNTRIES RESPONSES

It's important to underline the fact that since the non-binding nature of all the BEPS measures and the soft law approach of the OECD, the risk is that some countries could choose to not implement any of those measures.

The war of international tax revenue against multinational for the tax avoidance is just starting and with the Programme of work developed by the OECD things are finally changing.

The general fear from states is that further issues could be generated by this chaos if the Inclusive Framework does not produce a comprehensive consensus-based solution within the agreed G20 time frame. And that's why, since the general displeasure and the related fear about the taxation outcomes, countries are starting to catch the opportunity to impose various unilateral and uncoordinated tax measures. Those actions, if not stopped in the early stage could escalated in increasing compliance burdens, double taxation and more uncertainty about the future.

The main problem is (once again) that basically digital companies shift the profits to low-tax jurisdictions showing cost instead in high-tax jurisdictions, despite most of their business activity taking place in these economies. Sticking with article 4 of the OECD model tax convention and a related tardive response of tax authorities' things have developed this way. Our attention in this research is focused on the place of effective management that with a permanent establishment, and so the transfer price, basically allows multinational to choose where to pay the minimum amount of taxes.

What's peculiar is that the tech giants are mostly from the Silicon Valley (United States) and are allied with the actual American president Donald Trump. Speaking of that, with the new Tax Cut and the Job Act the corporate tax rate is set at 21% (instead of the old 35%) and exempting from taxation profits brought back home after they have been made and taxed abroad.

It's a fine move that allows United States to collect a huge amount of money on taxing those multinational, that along with the international fear of how things will develop in matter of taxation, could start a real "war of taxation".

This new scenario can be deadly for the entire economy, since in response of unilateral tax measure such as UK's Diverted Profits Tax, Italy's and France's Web Tax (3% rate on services physically sold in the country), the American president threatens to levy 100% duties on import products from those countries. Keeping in

mind that the American market is one of the most profitable from all over the word it's a serious risk that not all countries would take.

At this time political and revenue needs are too high and pressing for some countries in the absence of international consensus, which have to decide whether go ahead and act unilaterally to address problems arising from the digital sector.

The majority of unilateral measures however are based on new nexus, equalisation levy and withholding tax, but in particular the aim is always the same: establishing a nexus between the entity producing the income and the place where the income originates.

The French Minister for the Economy, Bruno Le Maire, calculate the hypothesis of taxing Internet giants no longer only for the estimates in financial report (thanks to CbCR) but by applying a 3% rate on services physically sold in France, this manoeuvre could generate an additional revenue of around €500 million per year.

Alongside French also the Italian government use the same strategy in the last year, but let's see in the specific how is composed.

3.8 ITALY'S WEB TAX

Starting from the bottom, The Italian Income Tax Code has also introduced a "Significant Economic Presence" (SEP) rule amended the definition of Permanent Establishment. With the new SEP the Italian Government overcome the article 4 of

the OECD model, that among other things, is the only one acknowledging by the state. The Significant Economic Presence rule shall apply where some factors, such as revenues and numbers of customers, are located. The new milestone is that physical presence is not necessarily needed to address a significant presence.

Italy has also passed a new transfer pricing rule that stipulates the use of valuation techniques other than cost-based indicators for determining the arm's length prices of digital transactions.

According to a recent study by "Mediobanca", an Italian Credit Institute, the total turnover in Italy in 2018 of the top 15 digital service companies in the world was 2.4 billion €, that in addition to being affected by aggressive tax optimization plans, actually expresses a very low collection of corporate taxes (64 million),

Even the risk of a war on levy duties, the 2018 Finance Law in Italy introduced a web tax, which will be applicable from January 2019 onwards. The 3% tax is applicable to Internet services distinguished by minimum human intervention and use of technology, provided both by Italian resident and non-resident entities to local business recipients. The new tax will be settled by the buyers of the service.

As far as the access thresholds are concerned, the minimum is 3000 transaction per years, 750 million € in total turnover and 5.5 million euros in digital services provided in Italy.

It's now clear that this measure wants to tax the big tech company but still the delicate issue of the location of taxable transactions remains.

The tax establishes that the criteria to identify the "nationality" of digital deals the computer/mobile/smartphone on which the intermediation service is finalized (Google, Facebook, etc.) must have geo-localized in Italy. It is even more laborious to establish the "quantum" tax for user profiling services, for which the "proportion of users for whom all or part of the data sold were generated or collected during the consultation, when they were located in the territory of the State, of a digital interface" is used.

CONCLUSIONS

Acknowledging that predictability and stability are fundamental building blocks of global economic growth, the rapid expansive digital transformation has had deep economic and social impact resulting in significant global changes.

In matter of taxation the problems created by this new economy have been avoided for too long, explaining so the trend toward monopolisation.

The tax implications are wide-ranging affecting both direct and indirect taxation, broader tax policy issues and tax administration.

At the centre of the debate is whether international income tax rules, which were developed in an economic environment from more than a century ago, remain fit for the new purpose in the modern global economy that is going digital. In particular, our research is based on two milestones of the global tax system that are identified in: where taxes should be paid and what portion of the profit should be taxed in each jurisdiction according to the so-called nexus rule.

Since the old rules created by the OECD model tax convention are based on the concept of physical presence, digital multinationals that operate in the world wide web catch this big opportunity to develop a fiscal strategy in order to reduce their tax burden, pursued with the use of a foreign subsidiary that basically allows company to choose where to pay taxes as seen in the Facebook case. The late response from tax authorises bring us to the current situation where a few big tech firms basically own the market.

The profit allocation related to transfer pricing techniques instead is based on the arm's length principle that is should be mandatory for all kind of operation (price equal to market price).

It's clear that the rules have enshrined tax certainty and helped to eliminate double taxation stimulating global trade, but now we are living in a digital era that allow companies to participate in a specific economic life of a jurisdiction without a meaningful physical presence.

Among the global dissatisfaction digital enterprises built their empire.

An unparalleled reliance on intangibles and the rising share of services in cross border trade are among the causes typically identified. This dissatisfaction has created a political imperative to act in a significant number of jurisdictions, as shown in the third chapter through the journey of the OECD starting from Action 1 in 2015 reaching the "Programme of Work".

The Inclusive Framework is therefore concerned that a proliferation of uncoordinated and unilateral actions would not only undermine the relevance and sustainability of taxation referred to cross-border business activities, but will also more broadly impact global investments and growth if the G-20 timeframe is not respected.

Some problems are still unsolved on the "Unified Approach" tax road. The difficulties are technical and has to deal with the metrics imposed by the digital economy.

How can a tax system attribute to a specific place and, therefore, to a State, the sale of a service that is not physical?

The eternal dilemma “source vs residence” seems to be solved thanks to the path of the OECD, that brings to the new concept of “significant digital presence” that takes into account the presence of a firm in a specific market without necessarily having a permanent establishment in the corresponding territory overcoming once and forever the Article 4 of the OECD model .

Unanimity is needed to approve a new unified approach on tax policy, curiously Ireland, Luxembourg and the Netherlands (among the others) are not fully embracing these new norms, due to the famous approach that they give to big tech companies.

The OECD will have the challenging task to find a common global taxation on this intricate and tricky issue. On national level instead, French Italian and English legislators are trying to devise remedies to the problem by mixing old and new instruments developing unilateral measures like the Web tax described before, and yet the risks of expose those countries with a lot more uncertainty are still there.

The OECD unified approach agreement will result in a cease-fire that avoid the commercial escalation which none of the contenders want. About the opponents, we have at one side the American president Donald Trump which is allied with the high-tech firm of Silicon Valley and want to bring back money to USA collecting taxes from those firms that are legally resident in America. On the other side we

have the Europe that has made it very clear that without an OECD agreement on the web tax is willing to pursue unilateral measures.

In this climate of fear and mistrust the OECD must prove his strength and respect the timeframe of the G-20 programme of work, because the global economy is in serious danger due to the fact that in response to unilateral measure, like the Italian and France Web Tax, the American President is willing to charge 100% duties on all import goods from that countries.

The dangerous pattern that the world has undertaken should be more clear on the next months, when a final answer will be delivered from the OECD, hopefully before the G-20 time frame, to finally put the word “end” on what is clearly configuring as the third world war, but this time it’s about taxation.

SITOGRAFIA

https://www.ilmessaggero.it/editoriali/francesco_grillo/web_tax_trump_ue-5003049.html

https://www.irishtimes.com/business/budget/budget-2020-main-points-free-gp-care-for-under-8s-extra-garda%C3%AD-to-be-recruited-1.4043175

https://www.irishtimes.com/business/economy/oecd-confident-on-digital-tax-deal-as-france-takes-swipe-at-ireland-1.4149005

https://corporatetaxhavenindex.org/methodology

https://www.linkiesta.it/it/article/2019/10/11/ocse-web-tax/43890/

https://economiafinanzaonline.it/cose-locse-e-quali-sono-i-suoi-compiti/guide/

https://www.forbes.com/sites/kellyphillipserb/2018/05/16/facebook-loses-bid-to-move-7-billion-tax-case-to-appeals/#2780ee7c7f99

https://www.forbes.com/sites/kellyphillipserb/2016/07/29/facebook-ignores-another-irs-summons-reveals-it-could-owe-billions-in-taxes/#60c1bcc86761

https://www.theguardian.com/politics/2019/oct/09/global-tax-shakeup-would-force-tech-firms-to-pay-more

https://www.irishtimes.com/news/world/europe/barnier-outlines-criteria-uk-must-fulfil-for-eu-market-access-1.4160520

http://www.oecd.org/tax/beps/tax-transparency/

https://www.irishtimes.com/news/politics/facebook-proposed-to-use-ireland-to-avoid-extra-digital-tax-1.3912646

https://www.propublica.org/article/whos-afraid-of-the-irs-not-facebook

https://www.irishtimes.com/business/economy/oecd-takes-aim-at-tech-giants-with-plan-to-shake-up-global-tax-1.4045073

https://www.theguardian.com/business/2019/nov/28/12-eu-states-reject-move-to-expose-companies-tax-avoidance

https://fiscomania.com/pem-residenza-fiscale-societa/

https://www.thejournal.ie/corporation-tax-ireland-2-4960036-Jan2020/

https://www.ft.com/content/1f740b46-539b-11e4-929b-00144feab7de?fbclid=IwAR2JY-DtcTksQw5oXT9guIbj2FFABzsCct-On08fxdaxormV813LhKps584&segid=0100320

https://www.ft.com/content/1f740b46-539b-11e4-929b-00144feab7de?fbclid=IwAR2JY-DtcTksQw5oXT9guIbj2FFABzsCct-On08fxdaxormV813LhKps584&segid=0100320

https://www.ft.com/content/ca64f938-5dc0-11e3-95bd-00144feabdc0

https://www.lexology.com/library/detail.aspx?g=10f973c3-2b09-4505-8ebd-93d40b60602c

http://www.in-formality.com/wiki/index.php?title=Double_Irish_(Ireland)

https://www.imf.org/external/pubs/ft/fandd/2019/09/tackling-global-tax-havens-shaxon.htm

https://www.europarl.europa.eu/RegData/etudes/STUD/2016/579002/IPOL_STU(2016)579002_EN.pdf

https://www.econstor.eu/bitstream/10419/186143/1/978-1-911534-94-5.pdf

http://www.oecd.org/berlin/publikationen/43324465.pdf

https://taxprof.typepad.com/files/70ti1195-ault.pdf

BIBLIOGRAFIA

Cotrut M., Munyandi K. *Tax Incentives in the BEPS Era, 2018*

Panayi C., *Advanced Issues in International and European Tax Law,* Bloomsbury, 2015

Frenkel J.A. Razin A, Sadka E, *International Taxation in an Integrated World,* 1992

Fuchs C. *The Online Advertising Tax as the Foundation of a Public Service Internet: A CAMRI Extended Policy Report,* University of Westminster Press, 2018

Reuven S. Avi-Yonah; *Advanced Introduction to International Tax Law: Second Edition*; Elgar advanced introductions, 2015

Rocha S.A., Christians A., *Tax Sovereignty in the BEPS Era*, Wolters Kluwer; 2017